Davis County Hospital

Accountants' Report and Financial Statements

June 30, 2006 and 2005

Davis County Hospital

June 30, 2006 and 2005

Contents

Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees
Davis County Hospital
Bloomfield, Iowa

We have audited the accompanying balance sheet of Davis County Hospital as of June 30, 2006, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Davis County Hospital as of and for the year ended June 30, 2005, were audited by other accountants whose report dated September 15, 2005 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2006 financial statements referred to above present fairly, in all material respects, the financial position of Davis County Hospital as of June 30, 2006, and its changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2006, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We and the other accountants have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information in 2006 and 2005, respectively. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the Hospital's basic financial statements. The accompanying supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. The supplemental information as of and for the year ended June 30, 2005, was audited by other accountants whose report dated September 14, 2005, expressed an unqualified opinion on such information in relation to the basic financial statements as of and for the year ended June 30, 2005, taken as a whole.

/s/ **BKD, LLP**

Kansas City, Missouri
September 29, 2006

Davis County Hospital
Management's Discussion and Analysis
Years Ended June 30, 2006 and 2005

Introduction

This management's discussion and analysis of the financial performance of Davis County Hospital (the "Hospital") provides an overview of the Hospital's financial activities for the years ended June 30, 2006 and 2005. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and cash equivalents increased between 2006 and 2005 by $121,333 or 16% and decreased between 2005 and 2004 by $1,084,886 or 59%.
- The Hospital's net assets decreased $150,715 or 2% in 2006 and increased $167,407 or 2% in 2005.
- The Hospital reported operating losses in both 2006 ($623,397) and 2005 ($238,308). The operating loss in 2006 increased by $385,089 or 162% over the operating loss reported in 2005 and the loss in 2005 increased by $173,197 or 266% over the operating loss reported in 2004.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets

One of the most important questions asked about any Hospital's finances is "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenses and Changes in Net Assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. The Hospital's total net assets—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors, should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash and cash equivalents during the reporting period.

The Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the Balance Sheet. The Hospital's net assets decreased by $150,715 or 2% in 2006 over 2005 as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2006	2005	2004
Assets			
Patient accounts receivable, net	$ 2,244,435	$ 2,946,428	$ 1,854,637
Other current assets	2,873,709	2,712,277	2,564,533
Capital assets, net	10,000,214	11,022,777	10,380,886
Other noncurrent assets	1,685,623	1,018,529	1,547,826
Total assets	$ 16,803,981	$ 17,700,011	$ 16,347,882
Liabilities			
Current liabilities	$ 2,934,750	$ 3,146,630	$ 2,416,943
Long-term debt	6,996,442	7,529,877	7,074,842
Total liabilities	9,931,192	10,676,507	9,491,785
Net Assets			
Invested in capital assets, net of related debt	2,534,657	3,027,347	2,933,106
Restricted expendable	458,067	352,742	463,375
Unrestricted	3,880,065	3,643,415	3,459,616
Total net assets	6,872,789	7,023,504	6,856,097
Total liabilities and net assets	$ 16,803,981	$ 17,700,011	$ 16,347,882

In fiscal year 2006, total assets decreased by $896,030 or 5%, which was mostly attributable to a decrease in accounts receivable of $701,993 or 24%. Part of the decrease in the 2006 accounts receivable is due to the Hospital installing a new computer system in February of 2005, which caused the accounts receivable to increase substantially at year end in 2005, and then subsequently the Hospital working on accounts receivable throughout 2006 and reducing the accounts receivable balances. Another significant change in assets is the increase in other noncurrent assets of $671,591 or 72% compared to 2005 due to the Hospital saving approximately $50,000 a month during 2006, which was part of the Hospital's cash management strategy. During 2005, the Hospital disposed several fully depreciated capital assets that were outdated or no longer used by the Hospital such as the home health computer system, defibulators, an ambulance, hematology equipment, a chemistry analyzer, x-ray unit and system, and various other major movable equipment.

In 2005, total assets increased by $1,352,129 or 13% over 2004. A significant change in the Hospital's assets in 2005 is patient accounts receivable, which increased $1,091,791 or 58% due to the conversion to a new software system in February 2005. In addition, increases in capital assets, net of $641,891 or 6%, contributed to the overall increase in total assets due to the replacement of major movable equipment during the year.

Operating Results and Changes in the Hospital's Net Assets

In 2006, the Hospital's net assets decreased by $150,715 or 2% as shown in Table 2. This decrease is made up of several different components.

Table 2: Operating Results and Changes in Net Assets

	2006	2005	2004
Operating Revenues			
Net patient service revenue	$ 11,960,921	$ 11,714,663	$ 10,583,865
Other operating revenues	449,363	488,600	499,891
Total operating revenues	12,410,284	12,203,263	11,083,756
Operating Expenses			
Salaries, wages and employee benefits	7,144,007	6,895,622	5,982,630
Medical professional fees	781,280	709,758	940,838
Depreciation and amortization	1,331,327	1,125,569	1,002,831
Other operating expenses	3,777,067	3,710,622	3,222,568
Total operating expenses	13,033,681	12,441,571	11,148,867
Operating Loss	(623,397)	(238,308)	(65,111)

	2006	2005	2004

Nonoperating Revenues (Expenses)			
County taxes	716,535	718,707	716,646
Interest expense	(391,932)	(367,727)	(421,724)
Interest income	49,633	22,482	14,328
Non-capital grants and gifts	96,555	28,432	25,166
Total nonoperating revenues	470,791	401,894	334,416
Excess Revenues Over Expenses Before Capital Grants and Contributions	(152,606)	163,586	269,305
Capital grants and contributions, net of restricted contributions	1,891	3,821	16,126
Increase (Decrease) in Net Assets	$ (150,715)	$ 167,407	$ 285,431

Operating Loss

The first component of the overall change in the Hospital's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In 2006, 2005 and 2004, the Hospital has reported an operating loss. This is consistent with the Hospital's recent operating history as the Hospital was formed and is operated primarily to serve residents of Davis County and the surrounding area. The Hospital levies property taxes to provide sufficient resources to enable the facility to serve patients.

The operating loss for 2006 increased by $385,089 as compared to 2005. The primary components causing the increase in the operating loss are as follows:

- Increase in total operating expenses of $592,110 or 5% as compared to 2005. The increase in total operating expense is partially due to increases of $248,385 or 4% in salaries, wages and employee benefits over 2005 due to employee salaries and severance pay to the prior CEO.

- Increase in depreciation and amortization of $205,758 or 18% as compared to 2005 due to the addition of new major movable equipment during 2005.

- Increase in other operating expenses of $66,445 or 2% as compared to 2005 due to an increase in patient days of 63 or 3%.

The operating loss for 2005 increased by $173,197 or 266% as compared to 2004. The primary components of the increased operating loss are:

- Net patient service revenue increased $1,130,798 or 11% over 2004.

- Total operating expenses increased $1,292,704 or 12% over 2004. The increase in operating expenses is partially due to the increase in salaries and wages and employee benefits of $912,992 or 15% due to 2005 being the first full year of a new physician office and increases in wage rates on average of 4-5%.

- Medical professional fees decreased $231,080 or 24% as compared to 2004 due to fewer contract professionals being needed.

- Other operating expenses increased $488,054 or 15% due to various departments' increases in supplies and other expenses.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of property taxes levied by the Hospital and interest income and interest expense, all of which remained relatively constant from 2006 to 2005.

Contributions

The Hospital received contributions of $96,555 and $28,432 from various individuals in 2006 and 2005, respectively.

The Hospital's Cash Flows

The Hospital's cash flows in 2006 increased by $861,144 as compared to 2005. The primary reason for the increase in overall cash flows in 2006 was due to the increase in net cash provided by operating activities of $902,900 or 277% due to improved receipts from and on behalf of patients.

Capital Asset and Debt Administration

Capital Assets

At the end of 2006, the Hospital had $10,000,214 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2006, the Hospital purchased new capital assets costing $315,850.

At the end of 2005, the Hospital had $11,022,777 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2005, the Hospital purchased new capital assets costing $1,883,534 of which $952,849 was financed through long-term debt.

Debt

At June 30, 2006 and 2005, the Hospital had $7,542,763 and $8,077,133 in hospital revenue bonds, loans and capital lease obligations outstanding. The Hospital issued no new debt in 2006. In 2005, the Hospital initiated a capital lease totaling $952,849 to purchase equipment.

Davis County Hospital
Management's Discussion and Analysis
Years Ended June 30, 2006 and 2005

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital Administration by calling (641) 664-2145.

Davis County Hospital
Balance Sheets
June 30, 2006 and 2005

Assets

	2006	2005
Current Assets		
Cash and cash equivalents	$ 886,852	$ 765,519
Assets held under bond indenture agreement	430,685	397,370
Short-term unrestricted investments	466,724	451,250
Patient accounts receivable, net of allowance; 2006 – $968,000, 2005 – $1,099,981	2,244,435	2,946,428
Property taxes receivable	679,624	698,499
Other receivables	20,463	45,414
Supplies	335,669	313,461
Prepaid expenses	53,692	40,764
Total current assets	5,118,144	5,658,705
Noncurrent Cash and Deposits		
Internally designated for capital acquisitions	1,454,094	854,662
Foundation assets	70,499	—
Externally restricted		
Held by trustee under bond indenture agreement for debt service	430,685	397,370
By donors	83,824	82,164
	2,039,102	1,334,196
Less amount required to meet current obligations	430,685	397,370
	1,608,417	936,826
Capital Assets	10,000,214	11,022,777
Other Assets		
Deferred financing costs	77,206	81,703
Total Assets	$ 16,803,981	$ 17,700,011

See Notes to Financial Statements

Liabilities and Net Assets

	2006	2005
Current Liabilities		
Current maturities of long-term debt	$ 546,321	$ 547,256
Accounts payable	524,381	410,228
Accrued expenses	920,187	1,065,734
Accrued interest	118,959	130,124
Estimated amounts due to third-party payers	145,278	294,789
Deferred revenue for property taxes	679,624	698,499
Total current liabilities	2,934,750	3,146,630
Long-term Debt	6,996,442	7,529,877
Total liabilities	9,931,192	10,676,507
Net Assets		
Invested in capital assets, net of related debt	2,534,657	3,027,347
Restricted-expendable for		
Debt service	311,726	267,246
Specific operating activities	146,341	85,496
Unrestricted	3,880,065	3,643,415
Total net assets	6,872,789	7,023,504
Total Liabilities and Net Assets	$ 16,803,981	$ 17,700,011

Davis County Hospital

Statements of Revenues, Expenses and Changes in Net Assets

Years Ended June 30, 2006 and 2005

	2006	2005
Operating Revenues		
Net patient service revenue before provision for uncollectible accounts	$ 12,170,111	$ 12,216,620
Provision for uncollectible accounts	(209,190)	(501,957)
Net patient service revenue	11,960,921	11,714,663
Other	449,363	488,600
Total operating revenues	12,410,284	12,203,263
Operating Expenses		
Salaries and wages	5,696,753	5,512,480
Employee benefits	1,447,254	1,383,142
Medical professional fees	781,280	709,758
Supplies and other	1,932,918	2,215,411
General services	945,116	886,734
Administrative services	792,095	497,797
Depreciation and amortization	1,331,327	1,125,569
Insurance	106,938	110,680
Total operating expenses	13,033,681	12,441,571
Operating Loss	(623,397)	(238,308)
Nonoperating Revenues (Expenses)		
County taxes	716,535	718,707
Interest income	49,633	22,482
Non-capital grants and contributions	96,555	28,432
Interest expense	(391,932)	(367,727)
Total nonoperating revenues	470,791	401,894
Excess of Revenues Over Expenses Before Capital Grants and Contributions	(152,606)	163,586
Capital Grants and Contributions, net of Restricted Contributions	1,891	3,821
Increase (Decrease) in Net Assets	(150,715)	167,407
Net Assets, Beginning of Year	7,023,504	6,856,097
Net Assets, End of Year	$ 6,872,789	$ 7,023,504

Davis County Hospital
Statements of Cash Flows
Years Ended June 30, 2006 and 2005

	2006	2005
Operating Activities		
Receipts from and on behalf of patients	$ 12,513,404	$ 10,792,708
Payments to suppliers and contractors	(4,479,331)	(4,398,766)
Payments to and on behalf of employees	(7,289,554)	(6,543,664)
Other receipts, net	478,550	475,891
Net cash provided by operating activities	1,223,069	326,169
Noncapital Financing Activities		
Property taxes	716,535	718,707
Noncapital grants and gifts	98,446	32,253
Net cash provided by noncapital financing activities	814,981	750,960
Capital and Related Financing Activities		
Principal paid on capital debt and leases	(543,309)	(332,480)
Interest paid on capital debt and leases	(403,097)	(395,226)
Proceeds from sale of capital assets	16,286	131,282
Purchase of capital assets	(315,850)	(930,640)
Net cash used in capital and related financing activities	(1,245,970)	(1,527,064)
Investing Activities		
Interest income	49,633	22,482
Purchases of investments	(520,954)	(112,933)
Net cash used in investing activities	(471,321)	(90,451)
Increase (Decrease) in Cash and Cash Equivalents	320,759	(540,386)
Cash and Cash Equivalents, Beginning of Year	2,099,715	2,640,101
Cash and Cash Equivalents, End of Year	$ 2,420,474	$ 2,099,715

(Continued)

Davis County Hospital
Statements of Cash Flows
Years Ended June 30, 2006 and 2005

	2006	2005
Reconciliation of Cash and Cash Equivalents to the Balance Sheets		
Cash and cash equivalents in current assets	$ 886,852	$ 765,519
Cash and cash equivalents in noncurrent cash and deposits		
Internally designated	948,613	854,662
Held under bond agreement	430,685	397,370
Externally restricted by donor	83,824	82,164
Foundation assets	70,499	—
	$ 2,420,473	$ 2,099,715
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by Operating Activities		
Operating loss	$ (623,397)	$ (238,308)
Depreciation and amortization	1,331,327	1,125,569
Loss (gain) on sale of capital assets	4,236	(1,770)
Changes in operating assets and liabilities		
Patient accounts receivable, net	701,993	(1,091,791)
Inventory	(22,209)	(47,992)
Estimated amounts due from and to third-party payers	(149,510)	169,836
Accounts payable and accrued expenses	(6,443)	408,991
Other	(12,928)	1,634
Net cash provided by operating activities	$ 1,223,069	$ 326,169
Supplemental Cash Flows Information		
Debt incurred for purchase of capital assets	$ —	$ 952,894

Davis County Hospital
Notes to Financial Statements
June 30, 2006 and 2005

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

Davis County Hospital is a county public hospital organized under Chapter 347 of the Code of Iowa. The Board of Trustees is elected by voters of Davis County. The Hospital primarily earns revenue by providing inpatient, outpatient and emergency care services to patients in the Davis County area.

The Davis County Hospital Endowment Foundation (Foundation) is included in the Hospital's financial statements as component unit using the blended method. The Foundation is a legally separate not-for-profit corporation that is, in substance, a part of the Hospital's operations and is primarily organized to benefit the Hospital.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific (such as county appropriations), property taxes, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, and do not conflict with or contradict GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2006 and 2005, cash equivalents consisted primarily of money market accounts and certificates of deposit.

Property Taxes

The Hospital received approximately 5.46% and 5.56% of its financial support from property tax revenues in the years ended June 30, 2006 and 2005, respectively, which were used to support operations. The Hospital levies the tax in March of each year based on assessed valuation of property in the County as of the second preceding January 1. Tax bills are sent by the County in August and the taxes are payable half on September 1 and March 1, and become delinquent after October 1 and April 1, respectively.

Property tax receivable is recognized on the levy or lien date, which is the date that the tax asking is certified by the County Board of Supervisors. The succeeding property tax receivable represents taxes certified by the Board of Supervisors to be collected in the next fiscal year for the purposes set out in the budget for the next fiscal year. By statute, the Board of Supervisors is required to certify the budget in March of each year for the subsequent fiscal year. However, by statute, the tax asking and budget certification for the following fiscal year becomes effective on the first day of that year. Although the succeeding year property tax receivable has been recorded, the related revenue is deferred and will not be recognized as revenue until the year for which it is levied.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, vision, short-term disability and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than those related to medical, dental and vision claims, for which the Hospital is self-insured. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Hospital is self-insured for a portion of its exposure to risk of loss from employee medical, dental and vision claims. Annual estimated provisions are accrued for the self-insured medical, dental and vision claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not reported.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	10 to 25 years
Buildings, improvements and fixed equipment	5 to 40 years
Moveable equipment	3 to 20 years

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using bonds outstanding method.

Compensated Absences

Hospital policies permit most employees to accumulate paid time off benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date, plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Net Assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable net assets.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and include estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were $51,813 and $28,467 for 2006 and 2005, respectively.

Income Taxes

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 presentation. The reclassifications had no effect on the changes in financial position.

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

- **Medicare.** Inpatient and outpatient services and defined capital cost related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for certain services at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Fiscal Intermediary. Estimated settlements have been reflected in the accompanying financial statements.

- **Medicaid.** Inpatient and outpatient services rendered to Medicaid Program beneficiaries were reimbursed based upon a cost reimbursement methodology. The Hospital is reimbursed at a tentative rate with the final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid Program.

Approximately 47% and 51% of net patient service revenues are from participation in the Medicare and state-sponsored Medicaid programs for the years ended June 30, 2006 and 2005, respectively.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Note 3: Deposits, Investments and Interest Income

Deposits

Custodial credit risk is the risk that, in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial risk requires compliance with the provisions of state law.

The Hospital had no bank balances exposed to custodial credit risk at June 30, 2006 and 2005. The Hospital's deposits in banks at June 30, 2006 and 2005 were entirely covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

Investments

The Hospital is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts, and warrants or improvement certificates of a drainage district. The Hospital had no investments at June 30, 2006 and 2005.

Summary of Carrying Values

The carrying values of deposits are included in the balance sheets as follows:

	2006	2005
Carrying value		
Deposits	$ 2,924,948	$ 2,550,009
Other	1,006	956
	$ 2,925,954	$ 2,550,965
Included in the following balance sheet captions		
Cash and cash equivalents	$ 886,852	$ 765,519
Assets held under bond indenture agreement	430,685	397,370
Foundation Assets	70,499	—
Other noncurrent cash and deposits	1,537,918	1,388,076
	$ 2,925,954	$ 2,550,965

Interest Income

Interest income for the years ended June 30, 2006 and 2005, amounted to $49,633 and $22,482, respectively.

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at June 30, 2006 and 2005 consisted of:

	2006	2005
Medicare	$ 807,981	$ 1,017,878
Medicaid	100,473	207,878
Other third-party payers	958,249	1,407,538
Patients	1,345,732	1,413,115
	3,212,435	4,046,409
Less allowance for uncollectible accounts	968,000	1,099,981
	$ 2,244,435	$ 2,946,428

Note 5: Capital Assets

Capital assets activity for the years ended June 30, 2006 and 2005 follows:

	Beginning Balance	Additions	Disposals	Transfers/ Adjustments	Ending Balance
2006					
Land and land improvements	$ 330,686	$ —	$ (41,847)	$ —	$ 288,839
Buildings	12,455,353	12,500	(133,016)	49,175	12,384,012
Fixed equipment	1,784,810	—	(269,508)	—	1,515,302
Major movable equipment	5,765,585	71,944	(1,539,767)	195,318	4,493,080
Construction in progress	33,621	231,406	—	(244,493)	20,534
	20,370,055	315,850	(1,984,138)	—	18,701,767
Less accumulated depreciation					
Land improvements	(194,143)	(7,625)	39,591	—	(162,177)
Buildings	(3,753,779)	(641,143)	128,374	—	(4,266,548)
Fixed equipment	(1,594,518)	(29,687)	268,744	—	(1,355,461)
Major movable equipment	(3,804,838)	(639,436)	1,526,907	—	(2,917,367)
	(9,347,278)	(1,317,891)	1,963,616	—	(8,701,553)
Capital assets, net	$11,022,777	$ (1,002,041)	$ (20,522)	$ —	$10,000,214

	Beginning Balance	Additions	Disposals	Transfers/ Adjustments	Ending Balance
2005					
Land and land improvements	$ 330,686	$ —	$ —		$ 330,686
Buildings	12,419,698	35,655	—		12,455,353
Fixed equipment	1,699,576	85,234	—		1,784,810
Major movable equipment	4,578,600	1,729,024	(542,039)		5,765,585
Construction in progress	—	33,621	—		33,621
	19,028,560	1,883,534	(542,039)		20,370,055
Less accumulated depreciation					
Land improvements	(184,697)	(9,466)	—		(194,143)
Buildings	(3,105,506)	(648,273)	—		(3,753,779)
Fixed equipment	(1,555,787)	(38,731)	—		(1,594,518)
Major movable equipment	(3,801,684)	(415,685)	(412,531)		(3,804,838)
	(8,647,674)	(1,112,155)	(412,531)		(9,347,278)
Capital assets, net	$10,380,886	$ 771,379	$ (954,570)		$11,022,777

Note 6: Medical Malpractice Insurance

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made.

Note 7: Risk Management

Liabilities include an accrual for claims that have been incurred but not reported for self-insured employee health benefits. Claims liabilities are re-evaluated periodically to take into consideration recently settled claims, frequency of claims and other economic and social factors. The Hospital is self-insured for employee medical, dental and vision benefits. Changes in the balance of claims liabilities during 2006 and 2005 are summarized as follows:

	2006	2005
Balance, beginning of year	$ 45,000	$ 45,000
Current year claims and changes in estimates	575,946	502,785
Claim payments	(572,946)	(502,785)
Balance, end of year	$ 48,000	$ 45,000

Note 8: Long-term Obligations

The following is a summary of long-term obligation transactions for the Hospital for the years ended June 30, 2006 and 2005:

	2006				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Hospital revenue bonds, Series 1998 (A)	$ 6,840,000	$ —	$ (230,000)	$ 6,610,000	$ 245,000
Rural economic loan agreement (B)	137,500	—	(36,667)	100,833	36,667
Capital lease obligations (C)	1,262,029	—	(276,642)	985,387	264,654
Less unamortized bond discount	(162,396)	—	8,939	(153,457)	—
Total long-term debt	$ 8,077,133	$ —	$ (534,370)	$ 7,542,763	$ 546,321

	2005				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Hospital revenue capital loan notes Series 1998 (A)	$ 7,065,000	$ —	$ (225,000)	$ 6,840,000	$ 230,000
Rural economic loan agreement (B)	174,166	—	(36,666)	137,500	36,667
Capital lease obligations (C)	379,949	952,894	(70,814)	1,262,029	280,589
Less unamortized bond discount	(171,335)	—	8,939	(162,396)	—
Total long-term debt	$ 7,447,780	$ 952,894	$ (323,541)	$ 8,077,133	$ 547,256

(A) Hospital Revenue Bonds, Series 1998, originally aggregating $8,300,000, were issued by the Hospital to finance building improvements. The bonds are payable through September 1, 2023, with interest coupons payable at March 1 and September 1 at annual rates varying from 4.2% to 5.625%. The bonds maturing on or after September 1, 2009 are subject to redemption by the Hospital on or after September 1, 2008, in whole or part, at a redemption price of 100% of principal plus accrued interest. The Bonds are collateralized by net revenues of the Hospital.

(B) Noninterest bearing loan agreement between Davis County, Iowa and a cooperative to foster economic development in rural areas solely used to improve the Hospital; dated June 17, 1999; payable in 36 quarterly installments of $9,167 without interest starting June 2000 through March 2008; payable exclusively from net revenues of the Hospital.

(C) At varying rates of imputed interest from 2.8% to 7.4% maturing through 2010 and collateralized by leased equipment.

Equipment includes the following property under capital leases:

	2006	2005
Equipment	$ 1,260,747	$ 1,569,784
Less accumulated depreciation	559,834	271,732
	$ 700,913	$ 1,298,052

The loan agreement also requires that payments be made to a Sinking Fund in amounts sufficient to pay the principal of and interest due on the bonds when due. Sinking funds available for payment of maturing bonds amounted to $430,685 and $397,370 at June 30, 2006 and 2005, respectively. At June 30, 2006 and 2005, deposits in the Sinking Fund were in excess of required amounts of $330,650 and $321,790, respectively.

The debt service requirements for the Hospital revenue bonds as of June 30, 2006, are as follows:

Year Ending June 30,	Total to be Paid	Principal	Interest
2007	$ 595,940	$ 245,000	$ 350,940
2008	594,369	255,000	339,369
2009	597,609	270,000	327,609
2010	600,045	285,000	315,045
2011	601,721	300,000	301,721
2012 – 2016	3,053,099	1,740,000	1,313,099
2017 – 2021	3,254,093	2,265,000	989,093
2022 – 2023	1,618,390	1,250,000	368,390
	$ 10,915,266	$ 6,610,000	$ 4,305,266

The debt service requirements as of June 30, 2006 are as follows for the Rural Economic Development Loan:

Year Ending June 30,	Total to be Paid	Principal
2007	$ 36,667	$ 36,667
2008	36,667	36,667
2009	27,499	27,499
	$ 100,833	$ 100,833

The following is a schedule by year of future minimum lease payments under the capital lease including interest together with the present value of the future minimum lease payments as of June 30, 2006:

Year Ending June 30,	Amount
2007	$ 295,124
2008	280,433
2009	280,432
2010	197,786
Total minimum lease payments	1,053,775
Less amount representing interest	68,388
Present value of future minimum lease payments	$ 985,387

Note 9: Restricted and Designated Net Assets

At June 30, 2006 and 2005, restricted expendable net assets were available for the following purposes:

	2006	2005
Debt service	$ 311,726	$ 267,246
Specific operating activities		
Project fund	81,025	79,479
Foundation assets	70,499	—
Other	6,362	6,017
Total restricted expendable net assets	$ 469,612	$ 352,742

Note 10: Pension Plan

Plan Description

The Hospital contributes to the Iowa Public Employees' Retirement System (IPERS), a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. Pension expense is recorded for the amount the Hospital is contractually required to contribute for the year. The plan provides retirement and death benefits, which are established by State Statute, to plan members and beneficiaries. The plan issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing to the plan at IPERS, P. O. Box 9117, Des Moines, Iowa 50306-9117.

Funding Policy

Plan members are required to contribute 3.7% of their annual covered salaries and the Hospital is required to contribute 5.75% of annual covered payroll for 2006 and 2005. Contribution requirements are established by State statute. The Hospital's contributions to the plan for 2006, 2005 and 2004 were $315,582, $299,745 and $265,579, respectively, which equaled the required contributions for each year.

Note 11: Network Administration and Support Services Agreement

The Hospital has entered into an agreement with another health care organization to provide computer network administration and support services. Administration and support services fees of $96,634 and $34,160 were incurred for the years ended June 30, 2006 and 2005, respectively.

Note 12: Budget and Budgetary Accounting

In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget on a cash basis following required public notice and hearings for all funds. The annual budget may be amended during the year utilizing similar statutorily-prescribed procedures.

The following is a reconciliation between reported amounts and cash basis presentation as well as a comparison to budget, for the year ended June 30, 2006:

	Actual	Accrual Adjustments	Cash Basis	Budget
Amount to be raised by taxation	$ 716,535	$ —	$ 716,535	$ 709,910
Other revenues/receipts	12,558,363	552,482	13,110,845	12,754,411
Total revenues/receipts	13,274,898	552,482	13,827,380	13,464,321
Expenses/disbursements	13,425,613	66,531	13,492,144	13,358,000
Change in net assets	(150,715)	485,951	335,236	106,321
Net assets, beginning of year	7,023,504	(1,445,192)	5,578,312	5,578,312
Net assets, end of year	$ 6,872,789	$ (959,241)	$ 5,913,548	$ 5,684,633

Supplementary Information

Davis County Hospital

Schedules of Patient Service Revenues

Years Ended June 30, 2006 and 2005

	2006			2005		
	Total	Inpatient	Outpatient	Total	Inpatient	Outpatient
Daily Patient Services						
Medical and surgical	$ 1,185,505	$ 1,185,505		$ 1,111,140	$ 1,111,140	
Swing bed	246,680	246,680		265,496	265,496	
	1,432,185	1,432,185		1,376,636	1,376,636	
Nursing Services						
Operating and recovery rooms	1,819,434	364,215	$ 1,455,219	1,595,192	347,387	$ 1,247,805
Emergency room	1,000,693	152,263	848,430	954,214	137,409	816,805
	2,820,127	516,478	2,303,649	2,549,406	484,796	2,064,610
Other Professional Services						
Laboratory	2,059,418	329,140	1,730,278	1,902,816	354,790	1,548,026
Central services and supplies	402,286	207,568	194,718	375,503	202,587	172,916
Electrocardiology	98,956	17,709	81,247	102,315	19,313	83,002
Radiology	3,227,071	78,289	3,148,782	3,223,738	99,412	3,124,326
Ambulance services	334,886		334,886	365,722	4,796	360,926
Labor and delivery	32,229	23,057	9,172	28,019	21,196	6,823
Cardiac rehabilitation	58,133		58,133	80,448		80,448
Pharmacy	1,560,576	846,205	714,371	1,626,720	905,959	720,761
Home health	134,139		134,139	108,411		108,411
Anesthesiology	175,611	42,016	133,595	152,827	42,693	110,134
Respiratory therapy	621,681	451,639	170,042	578,068	409,135	168,933
Physical therapy	1,125,791	352,387	773,404	1,578,645	406,965	1,171,680
Speech therapy	31,963	5,426	26,537	15,426	4,741	10,685
Electroencephalagraphy	5,282	1,761	3,521	5,529	962	4,567
Long term care	1,305,288	1,305,288		1,299,126	1,299,126	
Nursery	40,937	40,937		36,509	36,509	
Outpatient clinic	1,081,603		1,081,603	554,461		554,461
	12,295,850	3,701,422	8,594,428	12,034,283	3,808,184	8,226,099
Gross Patient Service Revenue	16,548,162	$ 5,650,085	$ 10,898,077	15,960,325	$ 5,669,616	$ 10,290,709
Contractual Adjustments	4,378,051			3,743,705		
Net Patient Service Revenue before Provision for Uncollectible Accounts	12,170,111			12,216,620		
Provision for Uncollectible Accounts	(209,190)			(501,957)		
Net Patient Service Revenue	$ 11,960,921			$ 11,714,663		

Davis County Hospital
Schedules of Other Revenues
Years Ended June 30, 2006 and 2005

	2006	2005
Revenues for expenses of Home Health Care:		
Davis County	$ 25,565	$ 47,973
Iowa Department of Public Health	38,875	69,493
Other funding	111,463	110,232
Ambulance subsidy – Davis County	25,000	32,500
Cafeteria	91,855	99,180
Sale of supplies and drugs	5,941	20,765
Rent income	43,295	43,230
Purchase discounts	70,611	26,978
Other	40,994	36,479
Gain (loss) on disposal of property and equipment	(4,236)	1,770
	$ 449,363	$ 488,600

Davis County Hospital

Schedules of Operating Expenses

Years Ended June 30, 2006 and 2005

	2006			2005		
	Total	Salaries	Other	Total	Salaries	Other
Nursing Services						
Medical and surgical	$ 736,994	$ 701,333	$ 35,661	$ 725,922	$ 685,023	$ 40,899
Emergency room	590,348	362,991	227,357	509,490	335,039	174,451
Operating and recovery rooms	249,017	172,010	77,007	233,023	150,052	82,971
Nursing administration	252,586	235,873	16,713	293,794	272,046	21,748
	1,828,945	1,472,207	356,738	1,762,229	1,442,160	320,069
Other Professional Services						
Laboratory	644,209	283,660	360,549	592,351	249,438	342,913
Central services and supplies	168,522		168,522	159,047		159,047
Radiology	638,457	208,411	430,046	716,712	207,469	509,243
Ambulance	271,983	237,889	34,094	251,808	203,834	47,974
Obstetric, labor, and delivery	72,980	64,429	8,551	58,980	51,649	7,331
Cardiac rehabilitation	34,588	28,407	6,181	34,436	30,016	4,420
Pharmacy	533,154	143,927	389,227	533,468	139,656	393,812
Home health	284,663	237,409	47,254	266,975	216,636	50,339
Anesthesiology	149,254		149,254	141,418		141,418
Respiratory therapy	184,966	119,420	65,546	177,766	111,898	65,868
Physical therapy	539,365	29,352	510,013	734,166	32,244	701,922
Speech therapy	20,481		20,481	11,700		11,700
Electroencephalography	2,016		2,016	2,208		2,208
Nursery	611	182	429			
Clinic	635,929	573,216	62,713	562,987	490,114	72,873
Nursing home	801,897	744,051	57,846	726,712	676,412	50,300
Medical records and library	151,940	107,202	44,738	148,619	104,887	43,732
	5,135,015	2,777,555	2,357,460	5,119,353	2,514,253	2,605,100
General Services						
Operation of plant	722,211	209,677	512,534	642,384	179,796	462,588
Dietary	504,256	226,889	277,367	492,285	232,940	259,345
Housekeeping	99,998	18,839	81,159	97,109	16,576	80,533
Environmental services	278,232	204,176	74,056	281,239	196,971	84,268
	1,604,697	659,581	945,116	1,513,017	626,283	886,734
Administrative Services	1,579,505	787,410	792,095	1,427,581	929,784	497,797
Employee Benefits	1,447,254		1,447,254	1,383,142		1,383,142
Depreciation	1,331,327		1,331,327	1,125,569		1,125,568
Insurance	106,938		106,938	110,680		110,680
	$ 13,033,681	$ 5,696,753	$ 7,336,928	$ 12,441,571	$ 5,512,480	$ 6,929,090

Davis County Hospital

Schedules of Patient Receivables and Allowance for Uncollectible Accounts Years Ended June 30, 2006 and 2005

Schedules of Patient Receivables

	Amounts		Percent to Total	
	2006	2005	2006	2005
Days Since Discharge				
0 – 60	$ 1,484,606	$ 1,531,978	39%	32%
61 – 120	634,967	676,880	17	14
121 – 180	267,222	409,015	7	9
181 – 365	165,283	338,945	4	7
366 and over	1,223,357	1,883,446	33	38
	3,775,435	4,840,264	100%	100%
Less contractual allowances	563,000	793,855		
	3,212,435	4,046,409		
Less allowance for uncollectible accounts	968,000	1,099,981		
	$ 2,244,435	$ 2,946,428		

Allowance for Uncollectible Accounts

	2006	2005
Balance, beginning of year	$ 1,099,981	$ 679,000
Provision for year	209,190	501,957
Recoveries of accounts previously written off	202,568	443,192
	1,511,739	1,624,149
Less accounts written off	543,739	524,168
Balance, end of year	$ 968,000	$ 1,099,981

Davis County Hospital

Schedules of Supplies and Prepaid Expense

Years Ended June 30, 2006 and 2005

Supplies

	2006	2005
Central stores	$ 31,902	$ 35,355
Pharmacy	125,318	110,722
Dietary	18,773	19,806
Laboratory	18,933	20,119
Office supplies	10,200	8,673
Floor supplies	126,056	114,298
Fuel oil	4,487	4,488
	$ 335,669	$ 313,461

Prepaid Expense

	2006	2005
Insurance	$ 17,044	$ 12,259
Service contracts	18,947	10,742
Dues	7,821	7,902
Maintenance and other	9,880	9,861
	$ 53,692	$ 40,764

Davis County Hospital
Schedule of Officials
Year Ended June 30, 2006

Name	Title	Term Expires
	Board of Trustees	
JoAnn Augspurger	Chairperson	2010
Leon Wilkinson	Vice-Chairperson	2008
Pat Van Arkel	Secretary/Treasurer	2010
Wayne Birchmier	Member	2008
Judy Carlson	Member	2010
Kevin Cook	Member	2006
Justin Swaim	Member	2006
	Hospital Officials	
Deborah Herzberg	Chief Executive Officer	

Davis County Hospital
Schedules of Financial and Statistical Data
Years Ended June 30, 2006 and 2005

	2006	2005
Patient Days (Exclusive of swing-bed)		
Medicare	1,488	1,439
Medicaid	152	152
Private and other	595	581
	2,235	2,172
Medicare and Medicaid Percent	73.4%	73.3%
Percent of Occupancy (Acute)	24.5%	23.8%
Discharges (Exclusive of swing-bed)		
Medicare	354	351
Medicaid	63	57
Private and other	208	207
	625	615
Average Length of Stay in Days	3.6	3.5

Davis County Hospital
Schedule of Insurance Coverage
Year Ended June 30, 2006

Chubb Group of Insurance (expires June 16, 2007)	
Building and contents, fire and extended coverage (100% co-insurance, replacement cost) (all locations)	$23,555,200/$5,000
Earthquake (expires June 16, 2007)	$10,000,000/$50,000
Blanket earnings and expense (expires June 16, 2007)	$4,319,106
Accounts receivable (expires June 16, 2007)	$250,000
General Liability - PIC Wisconsin (expires June 16, 2007)	$1,000,000/$3,000,000
Healthcare facility medical professional liability - PIC Wisc.	$1,000,000/$3,000,000
Owned automobiles - Iowa Fire/EMS Pak (ambulances) (expires June 16, 2007)	
Continental Western (All other autos) (expires June 16, 2007)	
Liability	$1,000,000
Collision/comprehensive ($1,000/$500 deductible)	No Limit
Uninsured/underinsured motorist (each)	$1,000,000
Hired vehicle/nonowned automobiles liability	$1,000,000
Blanket fidelity bond - Old Republic Surety Company (continuous)	$50,000
Employees and Board Members	$1,000 Deductible
Excess coverage on certain individuals	$200,000
Boiler (included in property coverage)	
Comprehensive accident coverage	
Mechanical Breakdown Limit	
Federal Insurance Company (policy expiration June 16, 2007)	$1,000,000
Trustees' and Officers' liability	$10,000 deductible
Employment Practices Liability Coverage	$15,000 deductible
United Fire and Casualty Company (continuous)	
Surety bonding (for LTC patient funds held by hospital)	$10,000
Farm Bureau Financial Services (policy expiration April 1, 2007)	
Workers' Compensation	Statutory
Petroleum Marketers Mutual Storage Tank (expires March 25, 2007)	
Financial Responsibility Program (release/aggregate)	$500,000/$1,000,000
	$10,000 deductible

Independent Accountants' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Trustees
Davis County Hospital
Bloomfield, Iowa

We have audited the financial statements of Davis County Hospital as of and for the year ended June 30, 2006, and have issued our report thereon dated September 29, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Hospital's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and responses as items 06-1, 06-2 and 06-3.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable conditions described above are not material weaknesses.

Twelve Wyandotte Plaza 120 West 12th Street, Suite 1200 Kansas City, MO 64105-1936 816 221-6300 Fax 816-221-6380

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted certain additional matters that are reported to the Hospital's management in a separate letter dated September 29, 2006.

Compliance with Certain Provisions of Iowa Law

The following comments about the Hospital's compliance with certain provisions of Iowa law for the year ended June 30, 2006 are based exclusively on knowledge obtained from procedures performed during our independent audit of the financial statements of the Hospital for the year ended June 30, 2006. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily examined. In addition, it should be noted that our audit was not directed primarily toward obtaining knowledge of compliance with the following items. Our procedures do not provide a legal determination on the Hospital's compliance with those requirements.

Official Depository Banks

A resolution naming official depositories has been adopted by the Board. The maximum deposit amounts stated in the resolution were not exceeded during the year ended June 30, 2006. However, the following was noted:

Criteria or Specific Requirement – Management is responsible for delivering the resolution naming official depositories to applicable financial institutions.

Condition – Management did not deliver the resolution naming official depositories to applicable financial institutions.

Context – Resolution was not delivered.

Effect – Financial institutions may not be aware of the limitations adopted by the Board regarding deposits of the Hospital.

Cause – Resolution is not delivered.

Recommendation – Management should deliver the resolution naming official depositories to applicable financial institutions.

Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendations. Management will perform suggested action to deliver the resolution to the applicable financial institutions.

Certified Budget

Budget hearings were held and publications were made in accordance with Chapter 24.9 of the Code of Iowa. Hospital expenses/disbursements during the year ended June 30, 2006 exceeded amounts budgeted.

Criteria or Specific Requirement – Management is responsible for maintaining expenses to the amount budgeted.

Condition – Actual expenses exceeded those budgeted for the year ending June 30, 2006.

Context – Actual expenses exceeded those budgeted.

Effect – There was an excess of expenses to what was approved with the budget.

Cause – Actual expenses were greater than anticipated.

Recommendation – Management should maintain expenses to the amount budgeted yearly.

Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendations. Management will seek to not have expenses in excess of budgeted amounts.

Questionable Expenditures

We did not note any questionable expenditures that we believe may constitute an unlawful expenditure from public funds or questionable disbursements that may not meet the public purpose requirements as defined in an Attorney General's opinion dated April 25, 1979. However, the following was noted:

Criteria or Specific Requirement – Management is responsible for establishing policies regarding questionable expenditures.

Condition – The Board of Trustees has not adopted written policies surrounding questionable expenditures that establish expenses considered to meet the public purpose and the required documentation for those expenditures.

Context – Written policies are not in effect.

Effect – Employees may not be aware of potential questionable expenditures and the need to document their public purpose.

Cause – Written policies are not in place.

Recommendation – Management should establish policies to inform employees of what is considered expenses that meet the public purpose and require documentation of that purpose.

Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendations. Management will perform suggested action to enact policies to conform to this requirement.

Travel Expense

No expenditures of Hospital money for travel expenses of spouses of Hospital officials were noted. Mileage reimbursement was approved for employees not in excess of the IRS allowable limits.

Business Transactions

We noted no transactions between Hospital and Hospital officials or employees other than those exempted by law; i.e., bankers on the Board of Trustees.

Director Minutes

No transactions were found that we believe should have been approved in the Director minutes but were not.

Deposits and Investments

We noted no instances of noncompliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the Hospital's investment policy.

Unclaimed Property

Prior to November 1, 2005, the Hospital was required to file an annual report of unclaimed property with the state treasurer in accordance with Chapter 556.11 of the Code of Iowa. We noted the following exception:

Criteria or Specific Requirement – Hospital management is responsible for filing a report of unclaimed property or a negative report if no unclaimed property is on hand.

Condition – A report noting no unclaimed property was not filed in 2006 for the year ended June 30, 2005.

Context – The Hospital had no unclaimed property, but no report was filed.

Effect – Requirements were not met under Chapter 556.11 of the Code of Iowa.

Cause – Necessary reporting was not made in the current fiscal year.

Recommendation – Management should ensure necessary reporting is completed each year.

Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendations. Management will perform suggested action to ensure all reporting is made in accordance with the Code of Iowa.

Disbursements for Equipment and Supplies

We did not note any disbursements for equipment or supplies that we believe were not in accordance with Chapter 347.13(3) of the Code of Iowa.

Compensation of Hospital Administrator, Assistants and Employees

No instances were noted in which compensation for the administrator, assistants or employees was determined other than in accordance with Chapter 347.13(5) of the Code of Iowa.

Internal Revenue Service Information Returns and Outside Services

We noted no instances where the Hospital failed to properly prepare a Form 1099 for outside services of $600 or more or failed to properly classify workers as independent contractors versus employees.

* * * * * * *

This report is intended solely for the information and use of the governing body and management and the State of Iowa, and is not intended to be and should not be used by anyone other than these specified parties.

/s/ **BKD, LLP**

Kansas City, Missouri
September 29, 2006

Davis County Hospital
Schedule of Findings and Responses
Year Ended June 30, 2006

Reference Number	Finding
06-1	Criteria or Specific Requirement—Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition—One individual has incompatible duties in the purchases cycle. Context—An individual responsible for processing cash disbursements and recording and monitoring disbursement information has duties that include access to assets, recording responsibilities and some monitoring responsibilities. Effect—Potentially material misstatements in the financial statements or material misappropriations of assets due to error or fraud could occur and not be prevented or detected in a timely manner. Cause—Duties in the purchases cycle are not adequately segregated and monitoring or other compensating controls are insufficient. Recommendation—Management should periodically evaluate the costs versus the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions—Management concurs with the findings and recommendations. Management will perform suggested evaluation and make any changes that are cost effective and operationally feasible within the next year.

Davis County Hospital
Schedule of Findings and Responses (continued)
Year Ended June 30, 2006

Reference Number	Finding
06-2	Criteria or Specific Requirement—Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition—Four individuals have incompatible duties in the revenue cycle. Context—Individuals responsible for processing cash receipts and recording and monitoring cash receipt information have duties that include access to assets, recording responsibilities and some monitoring responsibilities. Effect—Potentially material misstatements in the financial statements or material misappropriations of assets due to error or fraud could occur and not be prevented or detected in a timely manner. Cause—Duties in the revenue cycle are not adequately segregated and monitoring or other compensating controls are insufficient. Recommendation—Management should periodically evaluate the costs versus the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions—Management concurs with the findings and recommendations. Management will perform suggested evaluation and make any changes that are cost effective and operationally feasible within the next year.

Davis County Hospital
Schedule of Findings and Responses (continued)
Year Ended June 30, 2006

Reference Number	Finding
06-3	Criteria or Specific Requirement—Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition—Two individuals have incompatible duties in the payroll cycle. Context—Individuals responsible for processing payroll disbursements and recording and monitoring payroll information have duties that include access to assets, recording responsibilities and some monitoring responsibilities. Effect—Potentially material misstatements in the financial statements or material misappropriations of assets due to error or fraud could occur and not be prevented or detected in a timely manner. Cause—Duties in the payroll cycle are not adequately segregated and monitoring or other compensating controls are insufficient. Recommendation—Management should periodically evaluate the costs versus the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions—Management concurs with the findings and recommendations. Management will perform suggested evaluation and make any changes that are cost effective and operationally feasible within the next year.

Board of Trustees
Davis County Hospital
Bloomfield, Iowa

As part of our audit of the financial statements of Davis County Hospital for the year ended June 30, 2006, we studied and evaluated the Hospital's internal control structure. Because the study and evaluation was only part of the overall audit plan regarding the financial statements, it was not intended to be a complete review of all your accounting procedures and, therefore, would not necessarily disclose all reportable conditions or opportunities for improvement. A reportable condition involves matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Hospital's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. We observed the following matters and offer these comments and suggestions.

Documentation of Accounting Policies

The Hospital has no formal documentation of standard accounting procedures. We recommend documenting accounting procedures, such as general ledger maintenance, payroll processing, cash disbursement processing, and so forth, should an unforeseen emergency occur with accounting personnel. This would enable the accounting function to continue with a minimum of interruption to daily activities.

Required Vacations for Certain Employees

The Hospital has no formal policy requiring vacations to be taken by certain employees whose positions affect some aspect of the accounting and finance functions at the Hospital. We recommend requiring mandatory one week vacations be taken by such personnel yearly such that another employee performs the finance or accounting related tasks the employee is responsible for. Required vacations of finance and accounting personnel provide an added measure that may help reduce or prevent fraudulent behavior.

Restrictively Endorsing Checks

The current policy and practice of the Hospital does not require checks to be restrictively endorsed when received. We recommend implementing a policy requiring such endorsement as an added measure of control over the cash receipts function. We noted management is considering changing this process with the hiring of a new office manager.

Internal Controls

Segregation of Accounting Duties

We noted certain situations where Hospital personnel had duties that were not fully segregated from a proper internal control perspective as they relate to internal controls. We reviewed these situations with Hospital management and discussed mitigating procedures the Hospital has in place for each of the situations described below. As is typical with other small hospitals, due to the small number of administrative and business office staff, complete segregation of duties is difficult.

The segregation of duties were in the following areas:

Cash Disbursements—The Accounting Manager has the ability to issue checks, record checks that are paid, adjust the expense accounts and reconcile bank balances to the general ledger. She also has access to signed checks and can change master accounts payable vendor files.

Revenues and Cash Receipts—The Financial Services Manager, Insurance Clerks, Credit Collection Representatives and the Receipting Specialists have the ability to receive cash, adjust patient accounts for payments received and change the patient billing files.

Payroll – The Accounting Manager and Accountant have the ability to add employees to master files, issue and have access to payroll checks, perform all recording functions in addition to reconciling functions.

Accounts Receivable and Revenue Cycle Issues

We noted the following issues with respect to the accounts receivable and revenue cycle:

Managed Care and Commercial Insurance – There are no procedures in place to verify payments received on managed care and commercial insurance claims have been made in accordance with contract terms. We recommend implementing procedures to verify payments are being made in accordance with agreed-upon contractual rates to ensure appropriate reimbursement is being received.

Recording of Patient Charges—At year end, there were patient charges that were recorded in the accounting period subsequent to when the charges were incurred. Although not material to the financial statements as a whole, we recommend ensuring all patient revenues be recorded in the proper periods to ensure more accurate financial statements.

Recording of Contractual Allowance—During a portion of fiscal year ended June 30, 2006, Medicaid payments for long-term care residents were being posted against Accounts Receivable without recording the corresponding contractual allowances, thereby leaving Accounts Receivable overstated in the interim and year-end financial statements, resulting in an audit adjustment. We recommend training business office personnel to properly post third-party payments.

Commercial Insurance Billing—Patients whose Hospital charges are covered by commercial insurance were often not sent through the proper pre-certification process as is required by many commercial insurance payers. In addition, current insurance information was not always obtained from patients in advance, resulting in denials and write-offs. We recommend implementing procedures to train all business office and registration staff to obtain the proper information from patients to ensure claims are correctly filed and denials and write offs are kept to a minimum.

Self-Pay Accounts Receivable—Self-pay accounts receivable represents the Hospital's largest payer class at June 30, 2006 with 36% of total gross accounts receivable or $1,345,711 categorized in the self-pay category. While decreasing slightly over the prior year, the balance of self-pay accounts have virtually remained unchanged in 2006. We recommend dedicating business office staff to aggressively working these accounts in an effort to reduce the balance going forward and collecting the amounts owed to the Hospital.

Medicare Late Charge Billing—When late charges are processed for in-patient Medicare accounts, business office staff often do not bill Medicare for the charges if the original claim was already submitted. While there is no immediate reimbursement of these Medicare charges (the Hospital is reimbursed from Medicare on a per-diem basis), these claims should still be billed to Medicare, as this information is accumulated by the Centers for Medicare and Medicaid (CMS), which provides the Provider Statistical and Reimbursement (PS&R) report that is factored into the Medicare and Medicaid cost reports the Hospital files yearly. Not billing for these Medicare claims leaves vital information out of the PS&R reports that would have been factored into the overall charges of the facility on which Medicare reimbursement is determined.

Setting Charges—We noted instances where Medicare and Medicaid were reimbursing the Hospital in excess of charges billed, resulting in negative contractual allowances. We recommend performing a thorough review of the chargemaster and setting charges to be in-line with current third-party reimbursements.

Recording Medicaid and Medicare Settlements—During fiscal year 2006, cost report settlements and lump sum adjustments were recorded in the accounting records directly to the contractual allowance (contra-revenue) accounts instead of being recorded against the cost report receivable or payable accounts, thereby, overstating revenue by approximately $200,000 at year-end, resulting in an audit adjustment. We recommend recording all lump sum and settlement activity to the proper general ledger accounts to ensure more accurate interim financial statement reporting.

Accounting for Restricted Donations

Some funds designated by donors to be used to pay principal and interest payments on the 1998 Bond issuance have not yet been used for the restricted purpose. We recommend using donor restricted funds before general unrestricted cash to comply with accounting standards and to honor the donor's intent.

Bond Sinking Fund

At June 30, 2006, the cash balance in the 1998 Bond Sinking Fund is in excess of the required balance by approximately $100,000. We recommend reducing the sinking fund to the required level.

Support for Journal Entries

We noted a journal entry tested that did not have support attached to it. We recommend keeping support for journal entries should an entry be called into question at a later date.

Maintaining Support for Expenditures

In performing audit procedures required by the State of Iowa, we noted instances where proper documentation was not available to support certain expenditures.

- A Board Member reimbursement did not to have a supporting invoice.
- One travel reimbursement of 25 selected did not have supporting documentation.
- One mileage reimbursement of 25 selected did not have the number of miles driven properly documented on the travel reimbursement request form.

Risk Assessment Audit Standards

During the past year, the AICPA issued the Risk Assessment Suite of Standards (Statements of Auditing Standards Numbers 104 through 111). These Statements establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement in a financial statement audit and provide guidance on the design and performance of the audit procedures whose nature, timing and extent are designed to address the assessed risks. In addition, the Statements establish standards and guidance on planning and supervision, the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion on the financial statements.

Overall, the primary objective of these Statements is to enhance the auditor's application of the audit risk model in conducting audits by specifying a more in depth understanding of the organization and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the organization is doing to mitigate the risks. These standards are effective for fiscal years beginning on or after December 15, 2006.

These standards will have a significant impact on the Hospital's audit once they become effective, which will most likely be June 30, 2008.

Independent Assessment of Corporate Compliance Program

In the Office of Inspector General's (OIG) Supplemental Compliance Program Guidance for Hospitals of January 31, 2005, the OIG recommends that, "Hospitals should regularly review the implementation and execution of their compliance program elements. This review should be conducted at least annually and should include an assessment of each of the basic elements individually, as well as the overall success of the program." Furthermore, the OIG recommends that the review be conducted by individuals "independent of line management."

We understand through discussions with management and review of the corporate compliance questionnaire that the Hospital is operating under a corporate compliance program. During 2006, the Hospital conducted compliance committee meetings, performed compliance audits, performed a charge description master review, updated the corporate compliance plan and conducted compliance training and education. All of these functions contribute to the effectiveness of a corporate compliance program and should be continued in future years.

Although the Hospital is performing several functions related to its corporate compliance program, we noted on the corporate compliance questionnaire that the Hospital marked that it has not conducted an independent review of its corporate compliance program, prepared an audit work plan or conducted a risk assessment. We recommend the Hospital consider conducting an independent review of its corporate compliance program, preparing an audit work plan and performing a risk assessment of the corporate compliance program as suggested by the OIG.

* * *

We appreciate the opportunity to present these comments and suggestions. This letter does not express an opinion on the Hospital's overall internal control structure; it does, however, include items that we believe merit your consideration. We can discuss these matters further at your convenience and provide any implementation assistance for changes or improvements you may require.

This letter is intended solely for the information and use of the Board of Trustees and management and is not intended to be and should not be used by anyone other than these specified parties.

/s/ **BKD, LLP**

Kansas City, Missouri
September 29, 2006